Testimony of
JAMES A. TOES
Merrill Lynch & Co., Inc.
On Behalf of the Security Traders Association
Before the House Financial Services Committee
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
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Mr. Chairman, Members of the Subcommittee, I am pleased today to be testifying before you on the issue of securities fees. I am James A. Toes, Director, Merrill Lynch Equity Trading and President of the Security Traders Association of New York, which is an affiliate of the Security Traders Association, on whose behalf I am testifying today. The STA is composed of 30 regional affiliates and over 7,000 individual members throughout North America and Europe, and it is the largest group of its kind in the world. Its membership includes traders for securities firms and institutions, others are partners, specialists, floor traders, proprietors or registered representatives.

History of Fees

In 1996, Congress enacted the National Securities Markets Improvement Act (NSMIA) reforming regulation of the securities and mutual fund markets. NSMIA also restructured fees imposed by the various securities laws – including extension to NASDAQ trades of the transaction fees imposed by Section 31 of the Securities Exchange Act of 1934. In restructuring the fees, Congress intended to ensure a stable source of funding for the SEC while also ensuring that the fees did not grow so large that they became a de facto tax on savings and investment rather than a user fee – which is the very situation we find ourselves in today.

The new fee structure established by NSMIA was the result of a complex compromise worked out between House and Senate authorizers and appropriators, The House Ways and Means Committee, the Office of Management and Budget (OMB), and the SEC, following years of Congressional debate over a new SEC funding mechanism. Unfortunately, however, NSMIA has not controlled the growth of fees as originally intended.

The Need to Reduce Fees

Actual fee collections have significantly outpaced NSMIA's projections. We believe that the reason for this is the Congressional Budget Office and the OMB used conservative estimates of stock market growth which were relied on by Congress in drafting NSMIA. In FY 2000, actual collections from all sources (including Section 31, Section 6(b) and merger and tender fees) grew to $2.27 billion dollars - over six times the SEC's budget of $377 million. The latest CBO estimates show runaway growth in the fees from $2.478 billion in FY 2001 to $3.769 billion in FY 2005. In other words, total SEC fees are projected to raise $15.2 billion over the next five years while the SEC budget will require only a fraction of that amount over the same period. Without a change in law, these fees will generate $16 billion in excess of what Congress intended in NSMIA – over just the seven-year period of FY 2001 to FY 2007.

Another defect in the NSMIA fee structure is that it fails to accommodate changes in the securities markets. For example, if and when the NASDAQ's conversion to an exchange is completed, the current fee structure will result in a redirection to the General Fund of a significant portion of the fees that is currently made available to fund the SEC. Thus, we face the possibility of a fee structure generating billions of dollars in unanticipated fees, while at the same time creating a funding crisis for the SEC.

Clearly, this is not the scenario Congress intended when it redesigned the SEC funding structure in 1996 to reduce the amount of the fee surplus.

Impact on the Investing Public

Ultimately, the investing public shoulders the burden of these fees. Section 31 fees are a tax on personal savings and investment in the form of lower returns. And as more Americans invest, more people pay this tax. Indeed, the percentage of households owning equities has increased from around 32% in 1989 to over 50% in 2000. It is important to note that Americans of all income levels are increasing their savings through equity ownership. According to some of the most recent statistics, 29% of households with incomes between $15,000 and $25,000 own stock. Therefore this tax is paid by the smallest as well as the largest market participants.

Section 31 fees also burden those who participate in pension plans, including public pension plans. For example, over a five-year period many states' public pension plans will pay millions of dollars of Section 31 fees. Some examples include:

- California – nearly $18 million;
- New York – over $13 million;
- Ohio – approximately $4.6 million;
- Pennsylvania – approximately $6.5 million; and
- Texas – over $7 million.

At a time when the government is encouraging savings, it is inconsistent for it to levy this tax on investment.

Reforming the Fees

To address the growing burden of the fees, the STA supports legislation that:

- Reduces fee rates so they fulfill their intended purpose of funding the SEC, and are not acting as a tax on investment;
- Puts in place an automatic mechanism that will limit collections if the original fee rate cut does not reduce the actual collections as intended; and
- Creates a safeguard that fully protects the amount of collections currently projected to be made available to the appropriators including the funding necessary for the SEC.

The STA testified in the Senate in support of S. 143 which includes the provisions outlined above. We urge the House to develop legislation with these characteristics. The Senate bill also allows for growth in the SEC budget, including pay parity for SEC employees, which we also support.

Including safeguards to prevent overcollections and undercollections will ensure that no matter how high or how low today's fee projections are, the fees will still collect the actual amounts intended by Congress. We should not enact legislation only to find ourselves back here in another five years because the projections missed their mark, or that market structure changes created unintended shortfalls or windfalls in fee collections.

In closing, Mr. Chairman, the STA applauds you for scheduling this prompt hearing on an issue of great importance to our members across the United States. Thank you, and I will be happy to answer any questions.